

14-3983,09-4414-cv

Fezzani v. Bear, Stearns & Co., Inc.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

April Term, 2011

(Decided: January 30, 2015)

Docket No. 14-3983, 09-4414

ON PETITION FOR REHEARING

1 MOHAMMED FEZZANI, CIRENACA FOUNDATION, DR. VICTORIA BLANK, LESTER
2 BLANK, JAMES BAILEY, JANE BAILEY, BAYDEL LTD., MARGARET BURGESS,
3 PATRICK BURGESS, BOOTLESVILLE TRUST, AND ADAM CUNG,
4

5 Plaintiffs-Appellants,
6

7 v.
8

9 BEAR, STEARNS & CO. INC., BEAR STEARNS SECURITIES CORP., RICHARD
10 HARRITON, MORRIS WOLFSON, ARIELLE WOLFSON, ABRAHAM WOLFSON, TOVIE
11 WOLFSON, ANDERER ASSOCIATES, BOSTON PARTNERS, WOLFSON EQUITIES,
12 TURNER SCHARER, CHAN SASHA FOUNDATION, UNITED CONGREGATION
13 MESERAH, ISAAC DWECK, INDIVIDUALLY AND AS CUSTODIAN FOR NATHAN
14 DWECK, BARBARA DWECK, MORRIS I. DWECK, RALPH I. DWECK, JACK
15 DWECK, FAHNESTOCK & CO. INC., BARRY GESSER, MICHAEL REITER, AND
16 APOLLO EQUITIES,
17

18 Defendants-Appellees,
19

20 ARTHUR BRESSMAN, ANDREW BRESSMAN, RICHARD ACOSTA, GLENN O'HARE,
21 JOSEPH SCANNI, BRETT HIRSCH, GARVEY FOX, MATTHEW HIRSCH, RICHARD
22 SIMONE, CHARLES PLAIA, JOHN MCANDRIS, JACK WOLYNEZ, ROBERT
23 GILBERT, FIRST HANOVER SECURITIES, INC., BANQUE AUDI SUISSE
24 GENEVE, FOZIE FARKASH, RAWAI RAES, BASIL SHIBLAQ, IYAD SHIBLAQ,
25 KEN STOKES, MILLO DWECK, BEATRICE DWECK, RICHARD DWECK, ISAAC B.
26 DWECK, HANK DWECK, and DONALD & CO.,
27

28 Defendants.
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1 B e f o r e: WINTER, CABRANES, and LOHIER, Circuit Judges.

2
3 Petition for panel rehearing or rehearing en banc of a
4 portion of this panel's opinion and summary order dated May 7,
5 2013, which affirmed the district court's dismissal of federal
6 securities law fraud claims against a clearing broker and
7 individual investors. 716 F.3d 18; 527 Fed. Appx. 89. The
8 petition for panel rehearing is denied.

9 Judge Lohier concurs in part and dissents in part in a
10 separate opinion.

11
12 Max Folkenflik, Folkenflik & McGerity, New
13 York, New York, for Plaintiffs-Appellants.

14
15 Kerry A. Dziubek and Michael D. Schissel,
16 Arnold & Porter LLP, New York, New York, for
17 Defendants-Appellees Bear, Stearns & Co. Inc.
18 and Bear, Stearns Securities Corp. (Now J.P.
19 Morgan Securities Inc. and J.P. Morgan
20 Clearing Corp.).

21
22 Howard Wilson and Scott A. Eggers, Proskauer
23 Rose LLP, New York, New York, for
24 Defendant-Appellee Richard Harriton.

25
26 Anne K. Small, Michael A. Coley, Jacob H.
27 Stillman, John W. Avery, and Jeffrey A.
28 Berger, for amicus curiae The Securities and
29 Exchange Commission, Washington, DC.

30
31 WINTER, Circuit Judge:

32
33 This opinion addresses petitions for rehearing by appellants
34 from the court's summary order and from the opinion filed the
35 same day. It also addresses an amicus brief filed by the
36 Securities and Exchange Commission in support of the Petition for

1 Rehearing from the panel opinion. Familiarity with the summary
2 order, the panel opinion, and the dissent from the panel opinion
3 is assumed. We deny appellants' petitions.

4 I.

5 The petition for rehearing relating to the summary order
6 argues that this court's decision in Levitt v. J.P. Morgan, 710
7 F.3d 454 (2d Cir. 2013), filed just before the summary order, is
8 inconsistent with that summary order with respect to the
9 complaint's allegations of Bear Stearns' liability as the
10 clearing broker for Baron's fraud. We disagree.

11 We begin by noting that the issue in Levitt was whether the
12 common issues with regard to the liability of clearing brokers
13 for the fraud or manipulation of introducing brokers so
14 predominated over individual issues as to justify certification
15 of a class. See Fed. R. Civ. P. 23(b)(3). That issue
16 necessarily caused a discussion of the caselaw governing such
17 liability. That discussion stated in part:

18 III. Duty of a Clearing Broker (Generally)

19 We have previously said that "a clearing
20 'agent []' is generally under no fiduciary
21 duty to the owners of the securities that
22 pass through its hands"

23
24 [D]istrict courts in this Circuit have
25 distinguished two categories of cases.
26 First, in cases where a clearing broker was
27 simply providing normal clearing services,
28 district courts have declined to "impose []
29 liability on the clearing broker for the
30 transgressions of the introducing broker."
31 Fezzani v. Bear, Stearns & Co., 592 F.Supp.2d

1 410, 425-26 (S.D.N.Y. 2008). The district
2 courts have so held even if the clearing
3 broker was alleged to have known that the
4 introducing broker was committing fraud,
5 Fezzani, 592 F.Supp.2d at 425; even if the
6 clearing broker was alleged to have been
7 clearing sham trades for the introducing
8 broker . . . and even if the clearing broker
9 was alleged to have failed to enforce margin
10 requirements against the introducing broker
11 -- thereby allowing the introducing broker's
12 fraud to continue -- in violation of Federal
13 Reserve and NYSE rules.

14
15 In the second, much more limited
16 category of cases, district courts have found
17 plaintiffs' allegations to be adequate -- and
18 so have permitted claims to proceed -- where
19 a clearing broker is alleged effectively to
20 have shed its role as clearing broker and
21 assumed direct control of the introducing
22 firm's operations and its manipulative
23 scheme. Thus, in Berwecky v. Bear, Stearns &
24 Co., 197 F.R.D. 65 (S.D.N.Y. 2000), the
25 district court granted class certification in
26 a suit brought by investors against clearing
27 broker Bear, Stearns for its role in the
28 introducing firm A.R. Baron & Company's
29 ("Baron") scheme to defraud investors. The
30 Berwecky plaintiffs allege that Bear Stearns
31 "asserted control over Baron's trading
32 operations by, inter alia, placing Bear,
33 Stearns' employees at Baron's offices to
34 observe Baron's trading activities, approving
35 or declining to execute certain trades,
36 imposing restrictions on Baron's inventory,
37 and loaning funds to Baron." Id. at 67. The
38 plaintiffs alleged that Bear Stearns asserted
39 control over Baron's activities "in order to
40 keep A.R. Baron a viable concern while Bear,
41 Stearns . . . continued to reap the large
42 profits they received from their activities
43 with A.R. Baron." Id. The district court
44 found the allegations that Bear Stearns
45 "control[led]" the implementation of the
46 scheme to manipulate the price of securities
47 sold by Baron sufficient to satisfy Rule
48 23(b)(3)'s predominance requirement. Id. at

1 68-69.

2
3 Levitt, 710 F.3d at 465-67 (some internal citations omitted).

4 The petition argues that Levitt held that the allegations in
5 Berwecky were sufficient to state a claim for relief under Rule
6 12(b)(6) against a clearing broker. The petition further notes,
7 correctly, that the allegations in Berwecky that "[Bear Stearns]
8 asserted control over Baron's trading operations by, *inter alia*,
9 placing Bear, Stearns' employees at Baron's offices to observe
10 Baron's trading activities, approving or declining to execute
11 certain trades, imposing restrictions on Baron's inventory and
12 loaning funds to Baron," Berwecky, 197 F.R.D. at 67, are
13 substantially identical to those in the present case. The
14 complaint here alleges that "Bear Stearns assumed control over
15 and sent Bear employees to Baron to 'enforce that control'" and
16 required that every trade ticket be checked and "reviewed every
17 order at this discretion [to] determine whether to execute the
18 trade." Thus, because the pertinent factual allegations in the
19 present case and Berwecky are substantially identical, the
20 petition concludes that our affirmance by summary order resolved
21 the merits of the claim incorrectly.

22 However, Levitt also cited the district court opinion in
23 Fezzani twice favorably, the very decision that our summary order
24 affirmed, and any seeming inconsistency evaporates once it is
25 recognized that Levitt's discussion quoted above was entirely in

1 the context of determining only whether a class was properly
2 certified under Fed. R. Civ. P. 23(b)(3) and not whether the
3 factual allegations were sufficient under Rule 12(b)(6). Levitt,
4 710 F.3d at 465. Indeed, Berwecky was itself a district court
5 decision under Rule 23(b), and the issues regarding the legal
6 sufficiency of the allegations were never finally determined.
7 Berwecky, 197 F.R.D. at 68-69.

8 The issues regarding the sufficiency of the pleadings under
9 Rule 12(b)(6) are quite different from those regarding
10 certification of a class pursuant to Rule 23(b)(3). Whereas the
11 Rule 12(b)(6) inquiry goes to the merits, the Rule 23(b)(3) issue
12 is whether "law or fact questions common to the class predominate
13 over questions affecting individual members." In re Initial Pub.
14 Offerings Sec. Litig., 471 F.3d 24, 32 (2d Cir. 2006). As the
15 Supreme Court noted in Amgen Inc. v. Connecticut Ret. Plans &
16 Trust Funds, although

17 a court's class-certification analysis must
18 be "rigorous" and may "entail some overlap
19 with the merits of the plaintiff's underlying
20 claim," Wal-Mart Stores, Inc. v. Dukes, 564
21 U.S. 131 S. Ct. 2541, 2551 (2011), Rule 23
22 grants courts no license to engage in free-
23 ranging merits inquiries at the certification
24 stage. Merits questions may be considered to
25 the extent -- but only to the extent -- that
26 they are relevant to determining whether the
27 Rule 23 prerequisites for class certification
28 are satisfied.

29
30 133 S. Ct. 1184, 1194-95 (2013).

31 Therefore, Levitt's comment on Berwecky at most held that

1 Bear Stearns' alleged "control" of Baron was "sufficient to
2 satisfy Rule 23(b)(3)'s predominance requirement." Levitt, 710
3 F.3d at 467 (citing Berwecky, 197 F.R.D. at 68-69).

4 Because Levitt is not in conflict with our summary order in
5 Fezzani, the present panel did not overlook or misapprehend the
6 law as is required for rehearing by F.R.A.P. 40(a)(2). We,
7 therefore, reaffirm our holding that Bear Stearns' conduct as
8 alleged in the Amended Complaint is not sufficient to state a
9 claim for relief under Section 10(b) and Rule 10(b)(5). While
10 the Amended Complaint alleges in conclusory fashion that Bear
11 Stearns asserted "control" over Baron's trading activity, it
12 fails to allege facts showing how this "control" related to
13 fabricating "market" prices of particular securities and
14 communicating them to customers or to manipulating prices with
15 regard to any particular securities. Appellants allege that Bear
16 Stearns was aware of the manipulations, knew that these
17 manipulations were leading to a crisis, but continued to clear
18 trades that did not involve unnecessary exposure to itself.
19 Knowledge alone, however, is not enough to attach liability to a
20 clearing broker under Section 10(b). ATSI Commc'ns, Inc. v.
21 Shaar Fund, Ltd., 493 F.3d 87, 102 (2d Cir. 2007). Moreover,
22 there are legitimate reasons for clearing brokers to monitor the
23 trading activities of some introducing brokers. A clearing
24 broker guarantees the performance of buyers and sellers of the

1 securities being traded and often extends credit to clearing
2 brokers. Indeed, the complaint states that Baron was in deep
3 debt to Bear Stearns, reason enough to monitor Baron's
4 activities.

5 The facts alleged in the Amended Complaint, if proven, would
6 not show that Bear Stearns directed the fraud or instructed Baron
7 or Dweck¹ to set up sham transactions. There is a real danger of
8 harm to the financial industry in allowing such allegations to
9 suffice to subject clearing brokers to the cost of discovery and
10 perhaps a trial even though there is no evidence of participation
11 by the brokers in the fraud or manipulation. The potential of
12 such litigation would deter clearing brokers from engaging in
13 normal business activities -- guaranteeing performance, extending
14 credit, and therefore often monitoring the financial condition of
15 introducing brokers -- and drive up costs of trading generally.
16 See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S.
17 148, 163-64 (2008) ("extensive discovery and the potential for
18 uncertainty and disruption in a lawsuit allow plaintiffs with
19 weak claims to extort settlements from innocent companies," and
20 because "contracting parties might find it necessary to protect
21 against these threats, [this may] rais[e] the costs of doing

¹ Isaac R. Dweck is sued individually and as a custodian for Nathan Dweck, Barbara Dweck, Morris I. Dweck, Ralph I. Dweck, and Jack Dweck. Although appellants refer broadly to "the Dwecks," their allegations regarding the Dwecks seem to involve only Isaac R. Dweck.

1 business" and "[o]verseas firms . . . could be deterred from
 2 doing business" in United States security markets.). The
 3 complaint similarly alleges that Bear Stearns lent Baron money
 4 and propped it up, but this activity is integral to the ordinary
 5 clearing function of a clearing broker.² Finally, appellants
 6 fail to claim that Bear Stearns' alleged "control" was sufficient
 7 to render it a Section 20(a) control person with respect to
 8 Baron. The petition for panel rehearing with respect to Bear
 9 Stearns is, therefore, denied.

10 II.

11 We also address arguments, echoed in appellants' petition
 12 for rehearing, made in an amicus brief filed by the SEC. The SEC

² Appellants additionally argue that (1) they relied on Bear Stearns's confirmation statements in future purchases of stock; (2) the confirmations and monthly statements were themselves manipulative acts directed at plaintiffs; and (3) the panel overlooked binding state court precedent as to aiding and abetting liability. None of these arguments warrant rehearing.

Arguments (1) and (2) may be rejected because appellants have still failed to sufficiently allege conduct not involving the ordinary functions of a clearing broker, as discussed above.

Argument (3) -- regarding plaintiffs' state law claim of aiding and abetting fraud -- may also be easily dismissed. The District Court here dismissed that claim on the basis that "[a]s a matter of law, clearing brokers are not responsible or liable for the fraudulent sales practices of the introducing broker." Fezzani v. Bear, Stearns & Co., 592 F. Supp. 2d 410, 426 (S.D.N.Y. 2008) (citing Greenberg v. Bear, Stearns & Co., 220 F.3d 22, 29 (2d Cir. 2000)). Although Judge Crotty relied on federal rather than state precedent, the Greenberg case's holding on this point is expressly as to New York state aiding and abetting liability. New York state law is not to the contrary, and we have recently reaffirmed exactly this principle. See In re Amaranth Natural Gas Commodities Litig., 730 F.3d 170, 185 (2d Cir. 2013) ("[T]he mere performance of routine clearing services cannot constitute the aiding and abetting of fraud under New York law." (emphasis added)); Levitt, 710 F.3d at 466 ("Not does the 'simple providing of normal clearing services to a primary broker who is acting in violation of the law . . . make out a case of aiding and abetting against the clearing broker.'" (quoting Greenberg, 220 F.3d at 29))).

1 incorrectly reads our opinion as holding that, in any and all
 2 manipulation cases, liability attaches only to persons who
 3 communicate a misrepresentation to a victim. The SEC argues that
 4 "[t]he essence of manipulation is not a misrepresentation, but
 5 market activity -- the buying and selling of shares -- that
 6 itself creates a 'false pricing signal.' A manipulative
 7 transaction, such as parking, is an 'intentional interference
 8 with the free forces of supply and demand'" (quoting ATSI, 493
 9 F.3d at 100; In re Pagel, Inc., 33 S.E.C. 1003, 1985 WL 548387,
 10 *3 (1985), aff'd, 803 F.2d 942 (8th Cir. 1986)). Arguing that
 11 our opinion conflated manipulative conduct with
 12 misrepresentations, the brief further states:

13 This Court has similarly recognized that
 14 engaging in manipulative acts -- practices
 15 'that are intended to mislead investors by
 16 artificially affecting market activity' --
 17 are violations distinct from making
 18 'misrepresentations.' Ganino v. Citizens
 19 Utils. Co., 228 F.3d 154, 161 (2d Cir. 2000).
 20 Emphasizing that distinction is this Court's
 21 ruling that a manipulation claim requires
 22 'market activity aimed at deceiving investors
 23 as to how other market participants have
 24 valued a security.' ATSI, 493 F.3d at 99-
 25 100, 105 (emphasis added).
 26

27 [Pet. Panel Rehear. 4]

28 We write only to state the obvious: our opinion did not
 29 require that reliance by a victim on direct oral or written
 30 communications by a defendant must be shown in every manipulation
 31 case. Indeed, we agree with the propositions of law asserted by

1 the SEC that, in a manipulation claim, a showing of reliance may
2 be based on "market activity" intended to mislead investors by
3 sending "a false pricing signal to the market," upon which
4 victims of the manipulation rely. ATSI, 493 F.3d at 100.

5 However, the discussion in ATSI of "false pricing signal[s]
6 to the market" is derived from the Supreme Court's use of the
7 efficient market hypothesis to establish a rebuttable presumption
8 of reliance based on the effect of misrepresentations on the
9 market price of securities. Basic Inc. v. Levinson, 485 U.S.
10 224, 241-45 (1988). ATSI extended a variation of that theory to
11 market prices affected by manipulation. In the present case,
12 however, there is no claim that there existed a market in any
13 sense of the word for the shares Baron sold to appellants. The
14 shares in question are not alleged to have been traded in any
15 structure reasonably viewed as an independent market with
16 publicly reported prices purportedly representing arms-length
17 transactions based on supply and demand. See ATSI, 493 F.3d at
18 100-01 & n.4. Therefore, there is not a claim that the inflated
19 prices paid by appellants were based on "false pricing signal[s]
20 to the market." The allegations in the present complaint state
21 only that Baron sold shares to appellants at prices that were
22 manufactured by Baron salespeople but were represented as set by
23 trading in a market that was falsely represented to exist.

24 The appellants' and the SEC's concerns that our opinion

1 disregarded ATSI are, therefore, wholly unfounded. Not only did
2 our opinion cite ATSI repeatedly and quote extensively from it,
3 but it read ATSI in a way favorable to manipulation claims. Our
4 opinion stated the "market" "signaled" by manipulative conduct
5 need not be fully efficient -- a highly efficient market is an
6 unlikely site for manipulation, see Fezzani v. Bear, Stearns &
7 Co. Inc., 716 F.3d 18, 21 n.2 (2d Cir. 2013) -- and suggested
8 that a future court might create a rebuttable presumption of
9 reliance in a less-than-efficient market context. See id. What
10 we did not, and could not, say was that ATSI's holding and
11 rationale applies where no actual ongoing market for the
12 securities in question exists.

13 Our point is illustrated by the claims against Dweck. There
14 is no allegation that Dweck's parking transactions, and their
15 purported prices, were ever reported in a market. Indeed, there
16 is no allegation that the "prices" used in the parking
17 transactions -- or in sham transactions by others coordinated
18 with the parking -- were ever made known to the buyers of the
19 securities in question or that the securities were sold to
20 appellants at prices "signaled" by the prices used in the parking
21 or coordinated transactions. There are, in short, no factual
22 allegations that Dweck's parking transactions sent "a signal" to
23 any identified market or that any buyer or seller relied upon the
24 parking prices. In the entire 116-page complaint, appellants

1 have not specifically pleaded a causal link between any single
2 stock purchase or sale and a corresponding parking by Dweck or
3 coordinated transactions by others. See ATSI, 493 F.3d at 106-
4 07.

5 Even though each of the individual plaintiffs must show
6 reliance on a misrepresentation for which the particular
7 defendant is responsible, there is no factual allegation by any
8 of the eleven individual plaintiffs as to how the various
9 "signals," "appearances," or "illusions" emphasized in the
10 dissent as created by Dweck's parking moved the price they paid
11 for particular shares. Much of the dissent turns on an attempt
12 to confine the purposes of "parking" to avoiding downward
13 pressure on a security's market price. But parking, a tactic
14 that we agree can be a serious violation, can have many purposes.
15 To establish this, we need look no further than the SEC's own
16 description of Baron's frauds. Having found the lack of an
17 independent market for the securities fraudulently sold by Baron,
18 the SEC stated that "[w]hile persons may park stock for a variety
19 of reasons[,] Baron parked stock to maintain the appearance of
20 compliance with the commission's net capital rules." In re Bear,
21 Sterns Secs. Corp., 705 S.E.C. 537, 1999 WL 569554, *3 n.6
22 (1999).

23 We do not reject the "signals" theory. Far from it. We
24 simply recognize that it is a red herring given the nature of

1 appellants' claims. The pleading gaps described above are hardly
2 unintentional. The complaint seeks damages from all defendants
3 for all losses of all plaintiffs whether or not a particular
4 defendant is alleged to have engaged in a sham transaction in a
5 security purchased by a particular plaintiff. For example,
6 appellants' claims against Dweck lump together sales of
7 securities that Dweck did not park with those of securities he
8 did park. Appellants claim that Dweck is liable for all of the
9 losses of all of the plaintiffs whether or not the securities
10 they bought were the subject of Dweck's parking transactions.³
11 Clearly, ATSI's reference to false pricing signals to a market
12 necessarily has to involve -- in private actions for damages --
13 allegations of: (i) particular securities (ii) manipulated by
14 particular defendants (iii) causing the losses to the particular
15 buyers. See ATSI, 493 F.3d at 101-02. Appellant claims fail to
16 meet that requirement.

17 To sum up, the facts alleged in this complaint do not
18 involve any ongoing market affected by false pricing signals by
19 Dweck. What they involve are misrepresentations to the victims
20 by Baron salespeople as to how the price they were charging for
21 particular securities was arrived at. Dweck's role in parking

³ The complaint alleges on page 107 that Dweck is liable for losses in the "Manipulated Securities." Page 3 of the complaint defines "Manipulated Securities" to include several companies whose stock Dweck is not alleged to have parked or manipulated.

1 certain securities was unknown to, and not relied upon by, those
 2 who purchased identical securities, much less by those who
 3 purchased securities not parked by Dweck. Although the complaint
 4 occasionally references an "inflated" market or "price
 5 movements," there is no allegation that customers relied on
 6 publicly reported prices⁴ or anything other than the fraudulent
 7 representations of Baron salespeople. For all that appears in the
 8 complaint, the stock parking may have been intended to deceive
 9 regulators, as actually found by the SEC, 70 S.E.C. 537, 1999 WL
 10 569554, *3-4, and perhaps Bear Stearns, but is not alleged to
 11 have caused particular transactions. Our dissenting colleagues'
 12 discussion of market manipulation, while indisputable in the
 13 abstract, is used to create a theory of manipulation in the

⁴ The SEC's amicus brief states, in a footnote, that "the Commission previously found, and as judicially noticeable material confirms (i.e., news items, trading records, and public filings) the relevant securities traded 'in over-the-counter markets' (i.e., NASDAQ) and on AMEX. In re Bear, Stearns Secs. Corp., 54 S.E.C. 224, 228 (1999)." The citation has not led us to any SEC decision, much less one "finding" public trading of the securities in question. What the footnote may be referencing is a 1999 SEC decision, see In re Bear, Stearns Secs. Corp., 70 S.E.C. 537, 1999 WL 569554, *2 (1999), that includes a cursory description of Baron's intended activities when it was founded in 1992: "Bressman and others established Baron in 1992 to underwrite the issuance of securities of small issuers trading in the over-the-counter markets, and to carry on market-making and retail sales of such securities." This description hardly suffices to remedy the lack of any allegations in the complaint that transactions in the relevant securities and their pricing were publicly available or that the prices communicated by Baron salespeople were in any way related to publicly reported prices. Finally, and dispositively, even if publicly reported transactions with a connection to sales by Baron were alleged, they would not support the claims asserted in the complaint, which seeks to hold all defendants liable for all of the plaintiffs' losses. The suggestion that we take judicial notice of various unidentified documents that may or may not show public trades seems rather anomalous in light of the failure of the 116-page complaint to mention them and of the amicus brief's failure to provide detail. In any event, even if we discovered some public trading, that would not remedy the other problems described above.

